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SOME REVENUE IMPLICATIONS

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MARCH 1971

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**DIRECTORATE OF
INTELLIGENCE**

Intelligence Memorandum

*Some Revenue Implications Of The 14 February Oil Settlement
With The Persian Gulf States*

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
March 1971

INTELLIGENCE MEMORANDUM

Some Revenue Implications
Of The 14 February Oil Settlement
With The Persian Gulf States

Introduction

On 14 February 1971 the six Persian Gulf members of the Organization of Petroleum Exporting Countries (OPEC) -- Saudi Arabia, Iran, Kuwait, Iraq, Abu Dhabi, and Qatar -- reached a highly favorable settlement with the region's private oil producers. Acting in concert, these countries, which produce nearly all Persian Gulf output, won tax and price concessions that will greatly increase their oil revenues over the next five years.

These increased revenues come at a time when some Persian Gulf governments face balance-of-payments problems as well as limitations on development and defense spending. In other cases the increased revenues will merely add to already large coffers, both public and private. This memorandum estimates the level of increased revenue generated by the February 1971 agreement and analyzes briefly the impact that the increases will have on the individual countries.

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

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CONFIDENTIALThe Persian Gulf Oil Settlement

1. The very substantial Persian Gulf oil settlement on 14 February 1971 reflected the fact that the producing countries were in the negotiating driver's seat for the first time. The shift from a buyers' to a suppliers' market in 1970 was an outgrowth of especially heavy increases in demand by Western Europe and Japan at a time when supply restrictions and tanker shortages were caused by closure of the Suez and Tapline.* Capitalizing on this situation, Libya had already concluded an agreement in September 1970 that provided substantial income tax and posted price increases. This agreement set the stage for followup demands by OPEC** in December 1970 for higher revenues on the basis of regional settlements. The Persian Gulf States, as a group, began negotiating with the oil companies in early January leading to the present settlement.

2. The key features of the 14 February 1971 agreement are: (a) assurance from the producing countries of security of supply and stability of financial arrangements for five years (1971-75); (b) stabilization of the income tax rate on Gulf crude oil export profits at 55%; (c) uniform increase of 35¢ per barrel in the posted price (that is, the price on which taxes are based) of Gulf crude oil exports; (d) an inflation adjustment in the posted price of 2½% effective 1 June 1971 and on the first of each of the years 1973 through 1975; (e) a further increase of 5¢ per barrel in the posted price per year on the same

* The Suez Canal has been closed since the Arab-Israeli war of June 1967, and Tapline, ARAMCO's pipeline from Saudi Arabia to the Mediterranean, was inoperative from early May 1970 to 1 February 1971.

** The Organization of Petroleum Exporting Countries consists of Iran, Iraq, Saudi Arabia, Qatar, Abu Dhabi, Indonesia, Venezuela, Libya, Kuwait, and Algeria, which together produce 90% of the Free World's oil exports.

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four dates; and (f) elimination of some earlier allowances used by the companies in computing profits.*

3. The revenue increases to the Persian Gulf governments generated by the 14 February settlement are considerable.** In 1971 alone, revenues will increase about \$1.3 billion as a result of price increases and tax concessions alone. For the five years, 1971-75, the total revenue increase resulting from the agreement will amount to an estimated \$12.6 billion (see Table 1). The increase in revenue per barrel coupled with the rise in the volume of oil exports is expected to produce total revenues in 1975 about three times the 1970 level.

4. The disparity between the six countries in both total revenues and revenue increases is considerable and reflects primarily the differences in oil output and the rate of growth in oil output among the producers. Because of their pre-eminent output roles, Iran, Saudi Arabia, and Kuwait will receive most of the area's total revenue and increases derived from the new agreement -- roughly 86% of the total. Of the remaining three producers, Abu Dhabi will receive the largest amount of revenue and revenue increases. In Iraq, where only about one-third of the total oil output is exported via the Persian Gulf, the revenue increases generated by the 14 February 1971 settlement will account for only a part of Baghdad's total anticipated increase in revenue; the remainder is expected to come from negotiations now under way regarding a Mediterranean area settlement. Qatar, smallest producer of the six signatory states, will receive about \$330 million in increased

* For new posted prices in Persian Gulf oil through 1975, see Table 2.

** In the case of Iraq, about two-thirds of the oil is exported via the Mediterranean, while for Saudi Arabia only about 12% of output exits by the Mediterranean (via Tapline). The price of Iraqi and Saudi oil delivered at the Mediterranean will be determined by the outcome of the negotiations between the oil companies and the Libyan government.

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Estimated Oil Revenues and Revenue Increases of Persian Gulf Oil Countries
Resulting from the 14 February 1971 Settlement a/

	Million US \$							Average Annual Increase (Percent)
	1970	1971	1972	1973	1974	1975	Total 1971-75	
<i>Estimated total oil revenues based on pre-settlement provisions <u>b/</u></i>	3,495	4,239	4,973	5,723	6,318	7,002	28,255	15
Iran	1,050	1,305	1,510	1,725	1,960	2,240	8,740	16
Saudi Arabia (excluding Tapline)	1,140	1,376	1,760	2,164	2,392	2,637	10,329	18
Kuwait	829	968	1,059	1,148	1,233	1,336	5,744	10
Iraq (Persian Gulf)	106	159	170	170	170	170	839	10
Qatar	129	139	153	157	165	174	788	6
Abu Dhabi	241	292	321	359	398	445	1,815	13
<i>Estimated total oil revenues resulting from 14 September settlement <u>b/</u></i>	3,495	5,569	6,778	8,158	9,463	10,932	40,900	26
Iran	1,050	1,705	2,020	2,405	2,890	3,430	12,450	27
Saudi Arabia (excluding Tapline)	1,140	1,776	2,385	3,079	3,567	4,127	14,934	29
Kuwait	829	1,278	1,434	1,628	1,843	2,076	8,259	20
Iraq (Persian Gulf)	106	259	285	300	310	325	1,479	25
Qatar	129	179	203	222	245	269	1,118	16
Abu Dhabi	241	372	451	524	608	705	2,660	24
<i>Revenue increases resulting from settlement <u>c/</u></i>		1,330	1,805	2,435	3,145	3,930	12,645	
Iran		400	510	680	930	1,190	3,710	
Saudi Arabia (excluding Tapline)		400	625	915	1,175	1,490	4,605	
Kuwait		310	375	480	610	740	2,515	
Iraq (Persian Gulf)		100	115	130	140	155	640	
Qatar		40	50	65	80	95	330	
Abu Dhabi		80	130	165	210	260	845	

a. In addition to the six OPEC members, three other Persian Gulf oil producers -- Bahrain, Dubai, and Oman -- will benefit by the settlement, possibly obtaining a total of about \$450 million in additional oil revenues during 1971-75 on the basis of negotiated or legislated increases.

b. The average annual increases in exports in 1971-75, based on past trends and various indications of future output, are estimated as follows: Saudi Arabia 16%, Iran 14%, Iraq 10%, Kuwait 8%, Qatar 5%, and Abu Dhabi 11%.

c. The difference between what will actually be obtained under the new agreement and what would have been obtained without it is \$12,645 million for 1971-75.

Table 2

Prices in Persian Gulf Oil Through 1975

New Posted Prices (US Dollars per Barrel)								
Crude & Gravity	Pre- 14 Nov 1970	14 Nov 1970	15 Feb 1971	1 Jun 1971	1 Jan 1973	1 Jan 1974	1 Jan 1975	
Iranian - light 34°	1.79	1.79	2.17	2.274	2.381	2.491	2.603	
Iranian - heavy 31°	1.63	1.72	2.125	2.228	2.334	2.442	2.553	
Arabian - light 34°	1.80	1.80	2.18	2.285	2.392	2.501	2.614	
Arabian - medium 31°	1.59	1.68	2.085	2.187	2.292	2.399	2.509	
Arabian - heavy 27°	1.47	1.56	1.96	2.059	2.161	2.265	2.371	
Kuwait 31°	1.59	1.68	2.085	2.187	2.292	2.399	2.509	
Iraq - Basrah 35°	1.72	1.72	2.155	2.259	2.365	2.475	2.586	
Abu Dhabi - Marine 37°	1.86	1.86	2.225	2.331	2.439	2.55	2.664	
Abu Dhabi - Murban 39°	1.88	1.88	2.235	2.341	2.449	2.561	2.675	
Qatar 40°	1.93	1.93	2.28	2.387	2.497	2.609	2.724	
Qatar Marine 36°	1.83	1.83	2.20	2.305	2.413	2.523	2.636	
Price Increases (US Cents per Barrel)								
Crude & Gravity	14 Nov 1970	15 Feb 1971	1 Jun 1971	1 Jan 1973	1 Jan 1974	1 Jan 1975	Rise From 15 Feb 1971	Rise From 14 Nov 1970
Iranian - light 34°	--	38.0	10.4	10.7	11.0	11.2	81.3	81.3
Iranian - heavy 31°	9.0	40.5	10.3	10.6	10.8	11.1	83.3	92.3
Arabian - light 34°	--	38.0	10.5	10.7	10.9	11.3	81.4	81.4
Arabian - medium 31°	9.0	40.5	10.2	10.5	10.7	11.0	82.9	91.9
Arabian - heavy 27°	9.0	40.0	9.9	10.2	10.4	10.6	81.1	90.1
Kuwait 31°	9.0	40.5	10.2	10.5	10.7	11.0	82.9	91.9
Iraq - Basrah 35°	--	43.5	10.4	10.6	11.0	11.1	86.6	86.6
Abu Dhabi - Marine 37°	--	36.5	10.6	10.8	11.1	11.4	80.4	80.4
Abu Dhabi - Murban 39°	--	35.5	10.6	10.8	11.2	11.4	79.5	79.5
Qatar 40°	--	35.0	10.7	11.0	11.2	11.5	77.4	77.4
Qatar Marine 36°	--	37.0	10.5	10.8	11.0	11.3	80.6	80.6

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revenues during 1971-75 as a result of the February settlement.

5. The revenue gains achieved by the six OPEC producers are almost certain to result in similar increases for the non-member oil producers of the Persian Gulf, principally Oman, Dubai, and Bahrain. Increased revenues to the three non-members in 1971 alone should amount to about \$54 million -- Oman, \$36 million; Dubai, \$10 million; and Bahrain, \$8 million -- and for the full five years (1971-75) could mean increased revenues of about \$450 million. Total revenue gains to the Persian Gulf States as a result of the February agreement would amount to somewhat more than \$13 billion for the five-year period.

The Impact on Individual Countries

Saudi Arabia

6. The windfall of some \$4.6 billion during 1971-75 reinforces the already optimistic outlook for Saudi finances during the period ahead. More immediately, it should lead to some expansion in government outlays on non-defense development -- an area that has suffered in recent years as the government held to a balanced budget while allocating an increasing share of its revenues to defense* and was faced with meeting the costs of Khartoum and other aid payments to Jordan and the UAR.** Initial Saudi revenue forecasts for fiscal year (FY) 1971 (ending 21 August 1971) implied

* Saudi defense expenditures rose from 28% of budget outlays in fiscal year 1966 (25 October 1965 - 15 October 1966) to an estimated 42% in fiscal year 1970 while non-defense development fell from an estimated 36% to possibly less than 10% during the same time period.

** As a result of commitments made at the Arab Summit Conference in Khartoum, Sudan, after the June 1967 war, Saudi Arabia has paid about \$140 million annually in 1968-70 to the UAR (\$100 million) and Jordan (\$41 million). In addition, Saudi Arabia has made payments averaging somewhat over \$7 million per year since 1968 to cover the costs of a \$36.7 million purchase of arms made by Jordan from the United Kingdom.

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that non-defense development spending would be limited to about \$250 million, but the new oil settlement could easily add an additional \$100 million or more. This would permit the government to reinstate some of the infrastructural and agricultural settlement programs previously dropped or suspended. An increase in public developmental investment would also stimulate the private industrial and commercial sectors of the economy, which have slowed in the past two years because of a downturn in government developmental spending. Even if other government spending, including defense, also increases (as it almost certainly will), the added oil revenues should exceed total spending by a considerable margin. Thus, over the next four years, Saudi Arabia is expected to have significant budgetary surpluses.

7. Saudi Arabia's already large foreign exchange reserves will almost certainly increase. At the end of 1970, reserves were almost \$900 million, more than double the amount needed to meet the legal requirement for 100% currency coverage and adequate to cover over one year's imports at the 1969 rate. A rapid increase in foreign exchange holdings will provide the Saudis with options for paying off existing arms debts ahead of schedule and increasing the amount of aid they are currently paying to Jordan and the UAR, as well as stepping up economic development. Future decisions on aid extensions, however, almost certainly will be based more on political than financial considerations.

Iran

8. Iran, unlike Saudi Arabia, has not had large foreign exchange reserves in recent years, and its rapid economic and military expansion has led to considerable deficit financing and balance-of-payments problems. At the end of 1970, Iran's holdings of gold and foreign exchange had fallen to a six year low (about \$210 million), or less than two months' imports. The revenue increases generated by the February oil settlement afford Tehran an opportunity to push economic development further or to pay off burdensome short and long-term debts. It seems likely that the Shah

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will choose expansion and will spend to the limit of Iran's resources.

9. On 24 February -- ten days after the agreement -- the Shah proposed a budget for FY 1971-72 (21 March 1971 to 20 March 1972) that not only will consume all the increased oil revenues but also will require substantial deficit financing. The new budget will include a \$1.3 billion deficit, or one-fifth of the expenditures, which will be covered by drawdowns on foreign loans of about \$800 million and domestic borrowing of approximately \$500 million. Both forms of borrowing will exacerbate an already difficult financial situation. The increased recourse to foreign loans, some short-term, will increase the debt service ratio, which already is more than 15% of foreign exchange earnings and requires foreign payments in excess of \$150 million annually. By expanding its domestic borrowing, the government is using up credit normally available for private investment. Thus Iran will continue to walk a narrow financial tight rope.

Kuwait

10. In Kuwait, where oil provides about 95% of the government revenues, the probable increase resulting from the February settlement will help to swell total revenues in FY 1971-72 by about \$470 million to a total of about \$1,365 million.* The increase not only will make it easier to finance Kuwait's Khartoum and other aid payments,** but also will permit a significant growth in developmental spending and a large accumulation of reserves. Even assuming that growth in total spending is double the rate of last year -- that is, 10% instead of 5% -- Kuwait will have a surplus of about \$380 million in FY 1971-72. This

* Increase in FY 1971-72 (31 March 1971 - 1 April 1972) over FY 1970-71 budgeted revenue of \$894 million, of which \$848 million was to come from oil revenue.

** Khartoum payments at present amount to about \$91 million annually to the UAR. Payments to Jordan of about \$39 million annually have been suspended for political reasons, but may be resumed shortly.

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surplus when added to the already large reserves* would be equivalent to more than two years' imports.

Iraq

11. The increase in oil earnings from the February settlement -- about \$640 million during 1971-75 -- accounts for only about 30% of the total increase Iraq will receive when negotiations for its Mediterranean oil are settled. On the basis of the February settlement alone, however, Iraq will have sufficient additional revenues in 1971 to eliminate an anticipated deficit in its planned budget while increasing developmental spending about 22%. Developmental spending in recent years has been pared in order to accommodate the rapid expansion in other government expenditures, particularly for defense. The heavy debts incurred in conjunction with defense preparations coupled with its servicing of past loans for economic development have imposed a burden on Iraq's balance of payments and in recent years have caused occasional late payments and sharp prompting from creditors. The settlement of Iraq's Mediterranean production will raise revenues to the point where Baghdad will be able to increase government spending substantially, pay off some debts, and still accumulate large reserves.

Abu Dhabi, Qatar, and Other Gulf Emirates

12. Oil provides about 90% of the revenues of the five oil producing Emirates, [redacted]

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[redacted] Economic development has been allocated only about one-third of total revenues. There are, of course, some disparities among the individual countries, both in oil revenues received and spending patterns.

* At the end of 1970, official reserves amounted to \$203 million. [redacted]

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** In addition to Abu Dhabi and Qatar, these oil producing Emirates include Bahrain, Dubai, and Oman.

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13. Abu Dhabi, largest of the five oil producers, will receive the equivalent of about \$1,600 per capita in increased oil revenues in 1971 as a result of the recent settlement. This sheikdom, almost uniquely among the five, is expected to use substantial sums for economic development. In 1969, for example, more than half of its revenues went for this purpose. Nevertheless, large surpluses will accumulate [redacted]

[redacted]

[redacted]

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Conclusions

16. The February 1971 agreement will result in substantially increased revenues for Persian Gulf oil producers during its five-year life. Revenues in 1971-75 are expected to increase \$13 billion. Final settlement of the Saudi and Iraqi exports to the Mediterranean could add \$2 billion more.

17. The magnitude of the increase and its impact on spending patterns in individual countries will vary considerably. While Iran probably will spend all of its revenues, the others clearly will not. Iraq and Saudi Arabia (when the Mediterranean agreement is concluded) will likely spend considerable sums on both development and the military. Even so the increased earnings are so large that substantial additions to reserves seem certain. [redacted]

[redacted]

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18. Regardless of how these countries dispose of their increased earnings, nearly all the money will eventually return to Western Europe (and to a lesser extent Japan and the United States) either in the form of payments for increased imports or in various direct and portfolio investments.

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